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Supreme Court of the United States

OCTOBER TERM, 1932

No. 391

LEXINGTON WATER POWER COMPANY,
APPELLANT,

versus

WALTER G. QUERY, J. P. DERHAM, AND FRANK C. ROBINSON, AS MEMBERS OF AND CONSTITUTING THE SOUTH CAROLINA TAX COMMISSION, APPELLEES.

APPELLEES' ARGUMENT

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THE R. L. BRYAN CO., COLUMBIA, S. C.
1-9-33-60

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This is an appeal from the United States District Court for the Eastern District of South Carolina, three Judges sitting, convened pursuant to Section 266 of the Judicial Code. The appellant, complainant in the Court below, sought an interlocutory injunction to enjoin the individual members of the South Carolina Tax Commission from collecting a tax of five-tenths of one mill upon each kilowatt hour of electric power generated within the State.

From the order denying an interlocutory injunction an appeal was taken to this Court. The order was affirmed. 286 U. S., 525, 52 Supreme Court Reporter, 494.

The case is now on appeal from a final order of the three-Judge Court denying a permanent injunction.

STATEMENT

Lexington Water Power Company, a South Carolina corporation, generates all of its electric energy by water power within the State (R., 1, 4 and 6). Its dam and power plant were constructed under permission granted by the Federal Power Commission. It sells all of its electric energy, wholesale, to corporations having transmission and distribution lines in South Carolina and extending into North Carolina (R., page 8). It is required under the Act to pay the tax on the number of kilowatt hours generated, but not upon the sale of that which is generated.

Generally speaking, the Tax Act in question imposes (a) a tax of five-tenths of one mill upon each kilowatt hour of hydro-electric power generated within the State, (b) a tax of five-tenths of one mill upon each killowatt hour of electric power generated by steam within the State, and (c) a tax of five-tenths of one mill upon the sale within the State on each kilowatt hour of electric power: Provided, that if such seller procures electric power which has been subject to the payment of the excise, license or privilege tax hereinbefore provided, a credit on said tax to the amount of the excise tax already required to be paid by the person, firm or corporation generating the same within this State, shall be allowed.

Electric generating plants of ten horsepower or less, industrial plants generating power for their own use, or use upon their own premises by their *bona fide* operatives or employees, and plants of municipalities generating electricity for use of their own customers, are exempt from the payment of the tax.

Section 4 provides that if any part of the Act shall be adjudged to be invalid, such judgment shall not invalidate the remainder of the Act.

Discrimination

Assignment of error one (1) is to the effect that it is an unlawful discrimination not to have taxed gas companies and because the tax is not imposed upon the production of electricity by the use of oil and combustion engines.

The record shows that only two very small plants in the State are engaged in producing electricity by the use of oil or internal combustion engines (R., page 69 (9)). We contend, however, that it makes no difference whether there be little or much competition between electric power generated by appellant by the use of water power on the one hand, and that generated by use of internal combustion engines and gas on the other.

The State of Pennsylvaina taxed anthracite coal, but did not tax bituminous coal. This Court said in regard thereto:

> "But we need not dwell further on these considerations. The fact of competition may be accepted. Both coals being compositions of carbon, are, of course, capable of combustion and may be used as fuels, but under different conditions and manifestations, and the difference determines a choice between them even as fuels."
>
> *Heisler v. Thos. Colliery Co.*, 260 U. S., 245, 43 Sup. Ct. Rep., 83.

Nevertheless, under the provisions of Section 1 (c) of the Act, the tax is required to be paid on the sale of electricity which has not borne the tax on generation and this would include all electric power howsoever generated, provided the tax had not been paid on the generation.

We feel that this Court should not be further detained with argument upon the points made under this assignment, as the Court below has fully covered this matter. We, therefore, content ourselves by referring to the record, pages 50-51.

Assignment of error two (2) is to the effect that the Act unlawfully discriminates because it exempts from the tax industrial plants generating power for their own use or use of

their employees, and municipalities generating power for use of their customers.

This discrimination is neither arbitrary, oppressive nor capricious, and in this case is a lawful one based upon a real difference between the parties taxed and those enjoying the exemption under the Act.

> "The Constitution of Louisiana classifies the refiners of sugar for the purpose of taxation into those who refine the products of their own plantations, and those who engage in a general refining business, and refine sugars purchased by themselves or put in their hands by others for that purpose, imposing a tax only upon the latter class. To entitle a party to the exemption it must appear (1) that he is a farmer or a planter; (2) that he grinds the cane as well as refines the sugar and molasses; (3) that he refines his own sugar and molasses, meaning thereby the product of his own plantation. Whether he may also refine the sugar of others may be open to question; although by its express terms the Act does not apply to planters who granulate syrup for other planters during the rolling season. The discrimination is obviously intended as an encouragement to agriculture, and does not deny to persons and corporations engaged in a general refining business the equal protection of the laws."
>
> *American Sugar Refining Co. v. Louisiana,* 179 U. S., 89, 21 Sup. Ct. Rep., 46.

> "The complainant alleges that the tax will prohibit and confiscate the plaintiff's business, which is that of manufacturing fish, oil, fertilizer, fish meal and by-products from herring either in whole or in part; that the tax unreasonably discriminates against the plaintiff, as it levies no tax upon the producers of fish oil, etc., from other fish, and is otherwise extortionate; and that it contravenes the Act of Congress in lack of uniformity and in exceeding one per centum of the actual value of the plaintiff's property. The prophecies of destruction and the allegations of discrimination as compared with similar

manufacturers from salmon are denied by the Attorney General of Alaska, the latter denial being based upon a comparison of the statutes which of course is open. We are content however to assume for the purposes of decision that, not to speak of other licenses, the questioned Acts do bear more heavily upon the use of herring for oil and fertilizer than they do upon the use of other fish. But there is nothing in the Constitution to hinder that."

Alaska Fish Salting & By-Products Co. v. Smith, 255 U. S., 44, 41 Sup. Ct. Rep., 220.

"It is established that a distinction in legislation is not arbitrary, if any state of facts reasonably can be conceived that would sustain it, and the existence of that state of facts at the time the law was enacted must be assumed."

Rast v. Van Deman & Lewis Co., 240 U. S., 342, 36 Sup. Ct. Rep., 370-374.

See also: *Pacific Express Co. v. Seibert et al.,* 142 U. S., 339, 12 Sup. Ct. Rep., 250.

Hart Refineries v. Harmon, 278 U. S., 499, 49 Sup. Ct. Rep., 188.

State Board Tax Commissioners of Indiana v. Jackson, 283 U. S., 527, 51 Sup. Ct. Rep., 540.

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Brown-Forman Co. v. Ky., 217 U. S., 563, 30 Sup. Ct. Rep., 578.

Bell's Gap R. R. Co. v. Penn., 134 U. S., 232, 10 Sup. Ct. Rep., 533.

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Toyota v. Hawaii, 226 U. S., 184, 33 Sup. Ct. Rep., 47.

Wampler v. Lecompte, 282 U. S., 172, 51 Sup. Ct. Rep., 92.

Middleton v. Texas Power & Light Co., 249 U. S., 152, 39 Sup. Ct. Rep., 227.

It was entirely proper for the Legislature to exempt municipalities from this tax, as municipalities are agencies of the State, and their operations are conducted not for private gain, but for the benefit of the public.

Irvine v. Town of Greenwood, 89 S. C., 511, 72 S. E., 228.

Ordinarily municipal property and business conducted by it are not taxed.

State Const., 1895, Art. X, Sec. 4.

Hardwick v. Wolcott, 98 Vt., 343, 129 Atlantic, 159, 39 A. L. R., 1222.

Assignment of error three (3) is to the effect that the Act of the Legislature is invalid because it exempts from the sales tax electric current upon which the generation tax has already been paid.

This provision of the statute was intended to prevent doubly taxing the same electric energy. It was designed to relieve a purchaser of electric power who resells and distributes it to its customers from the payment of another tax upon the electricity on which the generation tax had been paid.

The Act simply recognizes the custom of trade that the generator paying the generation tax passes it on to the first purchaser, and if the first purchaser resells he passes the tax on to the consumer, and so it is that the consumer pays the tax indirectly in case of the generation tax, as well as in case of the sales tax, but is not required to indirectly pay more than the one tax.

> "The tax, to describe it according to its essential nature, is an excise upon domestic sale or storage, designed to affect the use of the products, a tax imposed at the time of inspection, the inspector acting also as tax gatherer, inspection and tax payment required but once, and that, ordinarily, from the dealer at the time of the first domestic sale, or during storage preliminary to such sale. The self-interest of the dealer and the customs of trade are relied upon to add the tax to the price of the product, and

thus pass it on to the ultimate consumer—a method appropriate in indirect taxation, and certainly a not unreasonable mode of distributing the burden among those who share in the benefits."

Texas Co. v. Brown, 258 U. S., 466, 42 Sup. Ct. Rep., 379.

Viewing the tax according to its essential nature, it is at the rate of five-tenths of one mill per kilowatt hour on all electric power generated in the State, and five-tenths of one mill on all power sold intrastate which has not borne the generation tax. The tax payment is required but once, and that from the domestic generator at the time of generation, and at the time of sale within the State on that which has not borne the tax on generation.

We may say in this connection, that South Carolina imposes a tax upon the business of selling cigarettes, cigars, other manufactured tobacco products, and bottled soft drinks; that revenue stamps are required to be placed on each individual article sold and that when once the revenue stamps are affixed, such articles may be resold any number of times and no additional tax is required.

And so it is on the sale of gasoline, the tax is required only on the first sale. It is thereby recognized that the final consumer indirectly pays the tax and that indrectly he should pay only the one tax and not have heaped upon him a multiplicity of taxes.

The tax is not imposed upon an agency of the Federal Government:

Assignments Nos. four (4) and eight (8) are to the effect that this is a tax on an agency of the Federal Government.

Appellant is chartered and doing business under the laws of South Carolina. It holds a permit from the Federal Power Commission to construct and operate its plant on one of the rivers of the State. By reason of the permit from the Federal Power Commission, it claims that it is an agency of the Federal Government in aid of navigation, etc. (R. p. 5), and,

therefore, beyond the taxing power of the State. Appellant in the production and sale of electric power is not acting as an agent of the Federal Government, but is engaged in private business for profit.

As was said by the Court below:

> "Complainants, in the production and sale of power, are not acting as agents of the government, but are engaged in private business for profit" (R., page 65).
>
> "The Act of Congress of course conveyed no title, and did not attempt to found one by delegating the power to take by eminent domain. *Western U. Teleg. Co. v. Pennsylvania R. Co.*, 195 U. S., 540, 574, 49 L. Ed., 312, 324, 25 Sup. Ct. Rep., 133, 1 Ann. Cas., 517. It made the erection of telegraph lines free to all submitting to its conditions, as against an attempt by a State to exclude them because they were foreign corporations, or because of its wish to erect a monopoly of its own. *Pensacola Teleg. Co. v. Western U. Teleg. Co.*, 96 U. S., 1, 24 L. Ed., 708. It has been held to prevent a State from stopping the operation of lines within the Act by injunction for failure to pay taxes. *Western U. Teleg. Co. v. Atty. Gen.*, 125 U. S., 530, 31 L. Ed., 790, 8 Sup. Ct. Rep., 961. But except in this negative sense, the statute is only permissive, not a source of positive rights."
>
> "These cases taken together, establish the proposition that the privilege given under the terms of the Act to use the military and post roads of the United States for the poles and wires of the company is to be regarded as permissive in character, and not as creating corporate rights and privileges to carry on the business of telegraphy, which were derived from the laws of the State incorporating the company, and that this permissive grant did not prevent the State from taxing the real or personal property belonging to the company within its borders, or from imposing a license tax upon the right to do a local business within the State."

Williams v. Talladega, 226 U. S., 404, 33 Sup. Ct. Rep., 118.

"But, furthermore, it seems to us extravagant to say that an independent private corporation for gain, created by a State, is exempt from State taxation, either in its corporate person or its property, because it is employed by the United States, even if the work for which it is employed is important and takes much of its time. *Thomson v. Union P. R. Co.,* 9 Wall., 579, 19 L. Ed., 792; *Union P. R. Co. v. Peniston,* 18 Wall., 5, 21 L. Ed., 787."

Baltimore Shipbuilding & D. D. Co. v. Mayor et al., 195 U. S., 375, 25 Sup. Ct. Rep., 52.

"The mere fact that property is used among others, by the United States as an instrument for effecting its purpose does not relieve it from State taxation. The most that can be said here is that among the public served by this railroad are some mines on land leased from the Choctaw Nation. The right-of-way and station ground in question, instead of being, as was perhaps originally contemplated by the Act of February 18, 1888, part of a branch to leased 'coal veins,' have become an integral part of through lines of a great railroad system. Holdenville is on the main line of the Choctaw, Oklahoma & Gulf, which extends from the west bank of the Mississippi River, through Arkansas and Oklahoma, to the Texas State line, a distance of nearly 650 miles. By the lease to the Rock Island, this railroad has become a part of the through lines of a much larger system. And even though it be granted that the Federal Government utilized the railroad as an instrument in working out its policy toward the Indians, the tax upon the railroad property would be none the less valid."

Choctaw, etc., v. Mackey, 256 U. S., 531, 41 Sup. Ct. Rep., 583.

In a very recent decision of the Court in a case where a power company had built a dam under a Federal license it was held that property owned and used by a private corporation for

private business advantage in exercise of a privilege, or franchise granted by the government, is subject to State taxation.

> "With that end in view, the distinction has long been taken between a privilege or franchise granted by the government to a private corporation in order to effect some governmental purpose, and the property employed by the grantee in the exercise of the privilege, but for private business advantage. The distinction was pointed out by Chief Justice Marshall in *McCullouch v. Maryland,* 4 Wheat., 316, 436, 4 L. Ed., 579, and in *Osborn v. Bank,* 9 Wheat., 738, 867, 6 L. Ed., 204; see *Union Pac. Railroad Co. v. Peniston,* 18 Wall., 5, 34-37, 21 L. Ed., 787. It has been followed without departure, and property so owned and used has uniformly been held to be subject to State taxation. . . .
>
> "The present case is not only controlled by the earlier decisions of this Court, but it would be difficult to suppose any case in which the adverse effect of a tax upon a governmental purpose would be more remote or attenuated, or in which the asserted immunity would more seriously impair the sovereign power of the State to tax, than in this one."
>
> *Susquehanna Power Co. v. State Tax Com. of Md.,* 283 U. S., 291, 51 Sup. Ct. Rep., 435.

See also,

> *Henderson Bridge Co. v. Kentucky,* 166 U. S., 150, 17 Sup. Ct. Rep., 532.

It is very certain that the construction of appellant's dam across Saluda River does not aid navigation, nor does it facilitate interstate and foreign commerce.

> "Saluda dam of Lexington Water Power Company as now constructed prevents the passage of any watercraft from a point below the dam to a point above the dam, and *vice versa* (R. pp. 73, 81).

So, whatever navigation that may have heretofore existed at the point of the erection of the dam is now completely destroyed.

The Act does not impair the obligation of a contract:

Assignment of error No. five (5) is to the effect that the Act in question violates Article I, Section 8, of the Constitution of South Carolina.

What particular part is violated is left to conjecture, but it is assumed that it relates to the inhibition against laws impairing the obligation of contracts.

The only contract the appellant in this case has with South Carolina is its charter, and it has not been made to appear that this charter grants any immunity from taxation.

By Statute of South Carolina the right is reserved to amend, alter or repeal any charter.

Code of Laws S. C., 1932, Vol. 3, Sec. 7676.
Tomlinson v. Jessup, 82 U. S., 454, 21 L. Ed., 204.
See also Constitution 1895, Art. 9, Sec. 2.

We refer this Court to what was said by the Court below on this subject (R., 67).

Conclusion

It is manifest by the general scope of the Act in question that the Legislature intended to raise revenue for the support of the State government by taxing the generation and use of electricity within the State. There is no longer a question of the power of the State to tax all electric energy which is generated within the State. *Utah Power & Light Company v. Pfost,* 286 U. S., 165, 52 Supreme Court Reporter, 548-553. However, the Legislature was confronted with the fact that much electric energy generated in Georgia and North Carolina is brought into South Carolina and here used. This State not having power to tax the generation of electric energy in other states and which energy is transmitted into South Carolina, went as far as it could in taxing that energy, to-wit, upon the sale thereof in South Carolina when it had lost its immunity from taxation as interstate commerce.

"The difference, however, is only such as arises naturally from the extent of the jurisdiction of the State in the

two classes of cases, and cannot be regarded as an unfriendly or unreasonable discrimination."

Shaffer v. Carter, 252 U. S., 37, 40 Sup. Ct. Rep., 227.

If such energy should be brought into the State and sold to individual consumers free of tax, it would be to the manifest disadvantage of electric energy generated in this State, therefore, the Legislature went as far as it could towards taxing the electric energy brought in from other states. And so it appears that the purpose of the Legislature was to tax the generation and the use of all electric energy in South Carolina.

It is true that the record shows that there are two generating plants within the State which use internal combustion engines, but these are shown to be of insignificant size. Perhaps this Court would take judicial notice that it is impossible to generate the vast quantities of electric energy consumed, by the use of internal combustion engines in competition with the vast hydro-electric developments and steam plants within the State. As the Court below said, it is no doubt true that the Legislature did not have its attention called to the two little plants operated by internal combustion engines (R. p. 50). However, under the provisions of the Act, this electricity of infinitesimal quantity is taxed upon its sale, just as power coming in from Georgia and other states is taxed upon its sale when it becomes local or intrastate business.

"In determining whether there is a denial of equal protection of the laws by such taxation, we must look to the fairness and reasonableness of its purposes and practical operation, rather than to minute differences between its application in practice and the application of the taxing statute or statutes to which it is complementary."

Gregg Dyeing Co. v. Query, 286 U. S., 472, 52 Sup. Ct. Rep., 631.

But with this general scheme of taxing all electric energy generated and used within the State, the Legislature has granted exemption to industrial plants which are principally textile manufacturing companies generating electric energy for their

own use (R. 390 p. 23) and for use of their *bona fide* employees, and municipalities generating electric energy for those who reside within the municipality.

We feel that under the decision of *Alaska Fish Salting & By-Products Co. v. Smith,* 255 U. S., 44, 41 Sup. Ct. Rep., 220, that the State is permitted to so arrange its taxation as to favor in this way the great and essential industries within this State, such as textile manufacturing companies. We think that this discrimination is based upon sound principles and for lawful reasons. It is, perhaps, generally and commonly known that the textile industry and other manufacturers have for some years been under a very great depression and sustaining heavy losses, except in very rare and remarkable cases; that these industrial plants afford the means of livelihood to many thousands of the people of South Carolina who otherwise would be without employment. They are engaged in purely private business and have no power of condemnation.

It is also generally known that the large corporations generating electric energy for sale are now, and for years past have been, making large profits. It is a very exceptional case where a power company has not made substantial profits and enjoyed prosperity when all others were suffering adversity, and the number employed in such activities is very small when compared with those engaged in the textile manufacturing business.

They are also public utilities and are granted power to condemn lands for right-of-way, for transmission lines, pondage area, etc.

Code of Laws S. C., 1932, Vol. 3, Secs. 8531-8540.
Lexington Water Power Co. v. Wingard, 148 S. E., 366.

The charter of Parr Shoals Power Company, now Broad River Power Company, grants power to condemn lands for pondage, etc.

Acts S. C., 1908, page 574.
Acts S. C., 1925, page 842.

As to exempting municipalities from the tax, we say that it is the public policy of the State not to place any tax on a municipality in South Carolina. The Constitution of the State forbids the taxation of municipal property used for public purposes. Constitution of S. C., Article X, Section 4. So far as we know and believe, there has been only one deviation in this State from the policy not to place a tax upon a municipality, and this instance was where the Legislature compelled cities and counties to pay a tax on the storage of gasoline. *City of Greenville v. Query,* 286 U. S., 472, 52 Sup. Ct. Rep., 631. And if we are correctly informed, it is the policy of all other states not to tax its municipalities. We, therefore, say that there is this fundamental reason for not imposing this tax upon municipalities.

The failure to apply this tax to gas companies, we think, is fully justified under the decision of this Court in the case of *Heisler v. Thos. Colliery Co.,* 260 U. S., 245, 43 Sup. Ct. Rep., 83.

The question presents itself under appellant's theory as to this; is it necessary to tax kerosene oil to make the tax valid on electric energy, because like electric energy kerosene is used for light, heat and power? We think not.

But if the exemptions complained of be contrary to any constitutional provisions and, therefore, unlawful, they should be construed as if they were not contained in the Act and the rest of the Act allowed to stand. For the Act provides, Section 4:

> "That if any clause, sentence, paragraph or part of this Act shall, for any reason, be adjudged by any Court of competent jurisdiction to be invalid, such judgment shall not affect, impair or invalidate the remainder of this Act, but shall be confined in its operation to the clause, sentence, paragraph or part thereof directly involved in the controversy in which such judgment shall have been rendered."

In discussing a similar provision in an Act of the State of Idaho, this Court said:

"It fairly may be assumed that the Idaho Legislature, in making this declaration, had in mind every provision of the Act, including Section 5. The primary object of the statute under review, plainly, is to raise revenue. The exemption made by Section 5 and the provisions for carrying that exemption into effect are secondary. We find no warrant for concluding that the Legislature would have been content to sacrifice an important revenue statute in the event that relief from its burdens in respect of particular individuals should become ineffective. On the contrary, it seems entirely reasonable to suppose that, if the Legislature had expressed itself specifically in respect of the matter, it would have declared that the tax, being the vital aim of the Act, was to be preserved even though the specified exemptions should fall for lack of validity. *Field v. Clark,* 143 U .S., 649, 696, 697, 12 S. Ct., 495, 36 L. Ed., 294; *People ex rel. Alpha P. C. Co. v. Knapp,* 230 N. Y., 48, 60-63, 129 N. E., 202."

Utah Power & Light Co. v. Pfost, 286 U. S., 165, 52 Supt. Ct. Rep., 548-553.

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